No. 511

IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 1920.

EDWARD S. ATWATER,

Petitioner.

vs.

STEPHEN G. GUERNSEY, SAMUEL H. BROWN, AND CHARLES A. HOPKINS, Trustees in Bankruptcy of MORTON ATWATER, *et al., &c.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER.

ABRAM J. ROSS,
FRANK B. LOWE,
Counsel for Petitioner.

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Cases Cited

SUPREME COURT OF THE UNITED STATES,

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EDWARD S. ATWATER, Petitioner, against STEPHEN G. GUERNSEY and others, Trustees in Bankruptcy of Morton Atwater, *et al.*, Respondents.	No. 511.

BRIEF FOR PETITIONER.

Statement.

THIS CASE COMES BEFORE THIS COURT ON CERTIORARI TO REVIEW A JUDGMENT OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The question of law to be reviewed by this Court, decided adversely by the Court below by a divided vote, is whether parol evidence was admissible to show the purpose for and the condition on which general releases under seal,

executed by the petitioner Edward S. Atwater to his son Eliot Atwater, of on advance to his son for the purchase of a seat on the New York Stock Exchange, in compliance with the rules and regulations of said Exchange, were given; which purpose and condition by the mutual agreement and understanding of the party was to protect creditor members of the Exchange only, and was not intended to be effective in favor of general creditors of the debtor. Such parol evidence, it is claimed, was permissible under well established rules laid down by this Court and other Federal Courts, as well as by the State Courts, and that the ruling below is in direct conflict with the decision by the New York Court of Appeals in *Sterling* v. *Chapin*, 185 N. Y., 395.

The judgment of the Circuit Court of Appeals sought to be reviewed herein was entered on the 1st day of June, 1920 (pp. 62-63), and affirmed by a divided vote an order and decree of the United States District Court, Southern District of New York, expunging the claim of Edward S. Atwater against the individual estate of Eliot Atwater, one of the members of the firm of Atwater, Foote & Sherrill, the above-named bankrupts, for the sum of Seventy-five Thousand Dollars ($75,000) monies advanced by the petitioner and used in the purchase of a seat for said Eliot Atwater on the New York Stock Exchange (pp. 51-52).

The trustees in bankruptcy of said firm objected to the allowance of the claim and moved

to expunge it, whereupon the matter was referred to a Special Master who made his report on the facts and held as a conclusion of law that the petitioner was estopped from asserting his claim by reason of the execution of said releases, and recommended that the petition of the trustees to reject and expunge such claim should be granted (pp. 43-45).

The report of the Special Master was confirmed by the District Court and an order was entered expunging and disallowing said claim (pp. 51-52).

From such order an appeal was taken by the petitioner to the Circuit Court of Appeals for the Second Circuit, which court as said, affirmed, by a divided vote, the decree appealed from.

A writ of certiorari has been allowed in the premises (pp. 63-64).

Statement of Facts.

Morton Atwater, Eliot Atwater, Gilbert F. Foote and Harold W. Sherrill in the year 1912 formed a partnership under the firm name and style of Atwater, Foote & Sherrill.

The original articles of co-partnership bear date June 1, 1912 (pp. 38-40).

Subsequently, and on the 3rd day of June, 1916, new articles of co-partnership were executed (pp. 40-42).

The firm carried on business under the original partnership agreement until the 3rd day of

June, 1916, and thereafter under the new articles until the failure of the firm and the placing of its affairs in bankruptcy.

The original articles provided that the contributions of the respective members should be as follows:

Morton Atwater, as capital, fifty thousand dollars $50,000

Gilbert F. Foote and Harold W. Sherrill, the good will of their previously established firm as agents of Post & Flagg, the value thereof being agreed upon as $10,000

Eliot Atwater, the use of a membership in the New York Stock Exchange.

The use of this seat was of great benefit to the firm. It lessened greatly the cost of purchasing and selling each day the securities bought and sold by the firm (p. 8). It also gave the firm the commissions each day earned by Eliot Atwater in buying and selling securities for outside parties.

The original articles further provided that all the earnings of Eliot Atwater as a member of the Exchange should accrue to the firm. They further provided that there should be paid to the said Eliot Atwater interest at the rate of six per cent. (6%) per annum upon the amount previously expended by him in purchasing a seat on the Exchange, being the sum of seventy-five thousand dollars ($75,000).

It was further provided that the business of the firm should be conducted in conformity with and subject to the constitution and rules of the New York Stock Exchange.

The articles also provided for a division of the profits equally between all co-partners.

The new articles contain the same provisions as the original articles except that the rate of division of earnings was changed: the interest to be paid Eliot Atwater was not to be upon the fixed sum of seventy-five thousand dollars ($75,000), but upon the average selling price during the preceding six months, and Foote was to be paid interest upon the same basis upon a Cotton Exchange seat.

The other changes in the articles are not material so far as concerns this controversy.

Eliot Atwater applied for a seat in the New York Stock Exchange and Edward S. Atwater, the petitioner, his father advanced the money to purchase the same (p. 7).

At that time and now the rules of the Stock Exchange require that before an applicant could purchase a seat thereon, he must file a general release from his debts and obligations. The purpose of this requirement appears in the Constitution of the Exchange as hereafter quoted (pp. 42-43).

When applying to the petitioner for the loan his son told him that for the purpose of complying with the said requirement of the Exchange it was necessary to sign releases in order to protect such creditors as might be members of

the Exchange against any prior lien on the seat in case of failure. This was before the signing of the release.

The petitioner on this subject testified as follows (p. 15):

> "He (Eliot) handed me the paper and said it was necessary for me to sign it, in accordance with the rules of the Stock Exchange, because the rule said about claims of members upon each other * * * it was necessary to waive my rights in accordance with that. * * * He told me it was necessary for me to sign that paper in accordance with the rules of the Stock Exchange, that it didn't amount to anything except to give the members of the Stock Exchange and the claims they might have against each other precedence over myself. I said I didn't think that amounted to anything and I signed it, though I didn't write to the Stock Exchange for any rules."

On the first day of May, 1912, the petitioner executed the releases in question (pp. 36-38) which were subsequently and before the transfer of the seat, delivered to the Stock Exchange authorities.

The releases upon their face, released Eliot Atwater from all claims, demands, etc., at that time existing in favor of his father, the petitioner. No parties are named in the instrument except the petitioner, Edward S. Atwater, and Eliot Atwater.

After the general release of all claims, demands, etc., the instruments recited in the one case—

> "And more particularly by reason of an advance of the sum of seventy-five thousand dollars ($75,000) made to said Eliot Atwater to enable him the said Eliot Atwater, to purchase a membership in the New York Stock Exchange." (p. 37).

and in the other case:

> "And more particularly by reason of an advance of two thousand and ten dollars ($2,010) made to said Eliot Atwater to enable him to pay his initiation fee to the New York Stock Exchange" (p. 38).

The purpose of the requirement of the New York Stock Exchange as to releases is shown in the following extracts taken from Article 15 of its Constitution:

> Sec. 3. Upon any transfer of membership, whether made by a member voluntarily, or by the governing committee, or the committee on admission in pursuance of the provisions of this constitution, the proceeds thereof shall be applied to the following purposes, and in the following order of priority, viz:—
>
> *First*: The payment of all fines, dues,

assessments and charges of the Exchange or any department thereof against members whose membership is transferred.

Second: The payment of creditors, members of the Exchange, or firms registered thereon of all filed claims arising from contracts subject to the rules of the Exchange, if and to the extent that the same shall be allowed by the Committee on Admission.

If said proceeds shall be insufficient to pay such claims as so allowed in full, the same shall be applied to the payment thereof pro rata.

Third: The surplus, if any, of said proceeds shall be paid to the person whose membership is transferred, or to his legal representatives, upon the execution by him or them of a release or releases satisfactory to the Committee on Admission (pp. 42-43).

It is conceded that there are no creditors of the firm of Atwater, Foote & Sherrill, members of the New York Stock Exchange, and no claim has been filed with the trustees by any creditor who are members of such Exchange (p. 44, Finding VI).

In the court below two questions were presented for decision:

(1) Was the Stock Exchange seat owned by the firm or was it the individual property of Eliot Atwater?

(2) Is the appellant (the petitioner) estopped from asserting his claim as against the firm or individual members?

The learned court below was unanimously of the opinion that the seat was the individual property of Eliot Atwater, but was divided in its opinion as to the effect of the releases given.

Circuit Judge Ward in an opinion dissenting from that of Circuit Judges Manton and Hough pointed out that while a release under seal could not be contradicted by one party as against the other or as against a third party who has been prejudiced by relying on it, in the absence of such prejudice both parties to a release may agree that as between themselves it was to be limited to a particular purpose and there being no evidence whatever in the case that any creditor of the bankrupt firm or of Eliot Atwater individually relied upon or even knew of the existence of the releases, there could be no estoppel in favor of the trustees in bankruptcy representing the creditors in general. The following quotation is taken from Judge Ward's dissenting opinion:

"In this case, for instance, if there had been no bankruptcy, Eliot Atwater and his father, Edward S. Atwater, could have agreed that the release though general was made for the benefit of the Stock Exchange creditors only and that the transaction was

as between themselves a loan by the father of the price of the seat to the son. If that was the fact, no other creditors of Eliot Atwater could prevent his father from recovering and collecting a judgment from him for the amount of the loan. So if Eliot Atwater had died, any admission by him to this effect could have been availed of by his father. *Sterling* v. *Chapin*, 185 N. Y., 395. On the other hand, any creditor of Eliot who had relied upon the release and who would be prejudiced by its being contradicted might insist upon its literal enforcement as to him. This on the ground of estoppel.

But there is no evidence whatever in this case that any creditor of the firm or of Eliot Atwater individually did so rely or even know of the existence of the release and I think there can be no estoppel in favor of the trustee in bankruptcy representing the creditors in general" (p. 62).

The majority of the court however, consisting of Judges Hogan and Maxton, placed their decision wholly on the ground that parol evidence was inadmissible to show the *purpose* for and the *condition* on which the releases were executed and that their effect must be determined solely by their express terms. We quote the following from the majority opinion:

"The scope and extent of a release depend as a rule upon the interest (intent) of the parties as expressed in the terms of the particular instrument. Parol evidence is inadmissible to prove that claims not included in the writing were understood at the time of the executing of the release to be embraced in the transaction. Parol evidence cannot be offered to vary the document (*St. Louis & S. F. Ry. Co.* v. *Dearborn Co.*, 60 Fed., 880; *Holbrook* v. *Sperling*, 239 Fed. Rep., 715). Parol evidence is admissible where, while not changing the nature of the contract, it shows the reason for the execution of the release and points out its use and application. But a valid release as conclusively estops the parties from reviving and litigating the claim released as a final act and it forever extinguishes a personal right of action. It completely discharges and extinguishes all rights and claims of the releasor against the releasee which are included in the release and this is true even though the releasee fails fully to perform a promise which was the consideration for the release unless the operation of the release was based upon full performance. Even if invalid, it is binding upon the parties until attacked in a proper manner and set aside. * * * A release like every other contractual obligation has for its primary rule of construction the intention of the parties. This must govern. This

intention, however, must be clear from the words used in the instrument and not from matter *de hors* the writing (*Hoes* v. *Van Hoesen*, 1 Barb. Chan. N. Y., 379 *Sherburne* v. *Goodwin*, 44 N. H., 271). The release here does not contain any limitation which would indicate an intent at the time of its execution of a conditional delivery so as to satisfy the requirements to purchase a membership upon the Exchange. We cannot read into the language of the release such limitation and thus defeat the claims of other creditors" (p. 60).

Thus while expressly admitting that parol evidence is admissible to show the *purpose* and *condition* of the delivery of an instrument, and that every contractual obligation has for its primary rule of construction the intention of the parties, the majority opinion holds that such rule is not applicable to a release, and that in order to limit its effect to the *purpose* for and the *condition* on which it was given such limitation must appear by the terms of the instrument itself and may not be established from matters *de hors* the writing.

The majority opinion, it is submitted, is in direct conflict with the rule laid down in many authorities by this Court and of universal application that, in the absence of estoppel, parol evidence *de hors* the writing is admissible for the purpose of showing the *purpose* of the execution of the writing and the effect which by the

agreement of the parties is to be given thereto.

The majority opinion is also in direct conflict with the decision by the Court of Appeals of the State of New York in *Sterling* vs. *Chapin*, 185 N. Y., 395, expressly holding that a release executed for the limited purpose of complying with the rules of the New York Stock Exchange and not with the intention of cancelling the indebtedness, would not bar recovery for the amount advanced for the purchase price of the seat by the releasor.

By the decision in the present proceeding, therefore, a direct conflict is created between the decision by the highest court of the State of New York and the decision by the Circuit Court of Appeals for the Second Circuit sitting in that State, as to the effect to be given to a release executed for the purpose only of complying with the rules of the New York Stock Exchange and with no intention as between the parties themselves of releasing the indebtedness except as to creditor members of the Exchange. In any proceeding brought in the State Court a release given for such a purpose will, therefore, be held to have an entirely different effect from that of the same or other release of like nature in a proceeding brought in the Federal Courts sitting in that State.

The membership of the New York Stock Exchange is 1100 members, four-fifths of whom execute releases under the requirements of the rules of the Exchange at the time of the purchase of their seats of similar character and im-

port to those in the present proceedings, and questions as to the rights of creditors, not members of the Exchange, are constantly arising by reason of members of the Exchange becoming insolvent, and numberless proceedings will in the future, as in the past be brought both in the State Courts and the Federal Courts, in insolvency and bankruptcy proceedings to establish the claims of creditors not members of the Exchange in the assets of an insolvent member. There is obvious necessity therefore of resolving the conflict between the decision of the highest court of the State of New York and the decision in this proceeding as to the rights of non-member creditors in the assets of an insolvent member of the New York Stock Exchange where a release has been given under the circumstances shown in the present proceeding.

BRIEF OF ARGUMENT.

First: The majority decision is in conflict with the rule of evidence announced by this Court and other Federal and State Courts, that in the case of any instrument, in the absence of an estoppel, it is always competent to show that it was not delivered, or that the delivery was upon certain conditions, or for a particular purpose.

Second: The majority decision is in direct conflict with the decision by the highest Court

of the State of New York in *Sterling* v. *Chapin*, 185 N. Y., 395, as to the effect of a general release given simply for the purpose of complying with the requirements of the rules and regulations of the New York Stock Exchange, and without an intention as between the parties to the instrument of discharging the indebtedness, except as to creditor members of the Exchange.

THIRD: The majority decision in its effect creates great confusion and inequality in the State of New York among creditors of insolvent Stock Exchange members, which dangerous and inequitable situation calls for a decision by this Court harmonizing the rule in the Federal courts with that in the State courts:

ARGUMENT.

POINT I.

In the absence of an estoppel, it is always competent to show that the delivery of an instrument was upon certain conditions or for a particular purpose, and its effect will be limited thereby.

By the express agreement and understanding between the petitioner and his son the releases

were executed wholly and solely for the purpose of complying with the rules and regulations of the Exchange *and for no other purpose*, and that *as between themselves the indebtedness would still exist* (Record, pp. 14-15).

That this was the understanding of the parties is wholly undisputed. The proof, therefore, is that the releases were given for a limited purpose only and on the condition that they should not discharge the debt, except as to creditor members of the Exchange.

Under such circumstances the releases should have been limited to that purpose and given no greater effect.

Peugh v. *Davis*, 96 U. S., 332;
Brick v. *Brick*, 98 U. S., 514;
Jackson v. *Lawrence*, 117 U. S., 679;
Cabrera v. *American Colonial Bank*, 214 U. S., 224;
Valdes v. *Central Altagracia*, 225 U. S., 58;
Ducie v. *Ford*, 138 U. S., 587;
Western Underwriting & Mortgage Co. v. *Valley Bank of Phoenix*, 237 Fed. Rep., 45;
Lumley v. *Wabash Railroad Co.*, 76 Fed. Rep., 66.

To the same effect are the decisions by the highest court in the State of New York.

Herrick v. *Carman*, 10 Johnson, 224;

Grierson v. *Mason*, 60 N. Y., 394;
Matthews v. *Sheehan*, 69 N. Y., 585;
Juilliard v. *Chaffee*, 92 N. Y., 529;
Marsh v. *McNair*, 99 N. Y., 174;
Schmittler v. *Simon*, 114 N. Y., 176;
Ensign v. *Ensign*, 120 N. Y., 655;
Thomas v *Scutt*, 127 N. Y., 133;
Blewitt v. *Boorum*, 142 N. Y., 357;
Baird v. *Baird*, 145 N. Y., 659;
Higgins v. *Ridgway*, 153 N. Y., 130;
Sterling v. *Chapin*, 185 N. Y., 398;
Grannis v. *Stevens*, 216 N. Y., 583;

In *Peugh* v. *Davis*, *supra*, this court had before it a deed absolute in form but claimed to have been executed as security for a loan of money. It was held that evidence *de hors* the writing was admissible to show the real purpose of the transaction.

In *Brick* v. *Brick*, *supra*, the rule in *Peugh* v. *Davis* was followed with respect to a pledge of a certificate of stock as security for a loan of money.

In *Cabrera* v. *American Colonial Bank*, *supra*, in which it was claimed that a bill of sale was an absolute conveyance and accomplished the payment of debts to a bank, this court said:

> "The face of an instrument is not always conclusive of its purpose. In equity extrinsic evidence is admitted to show that a conveyance absolute on its face was intended as security. The rule regards the circum-

> stances of the parties and executes their real intention and prevents either of the parties to the instrument committing a fraud on the other by claiming it as an absolute conveyance notwithstanding it was given and accepted as security. In other words, the real transaction is permitted to be proved."

In *Grierson* v. *Mason*, *supra*, the plaintiff tried to prove that his commissions were to amount to at least $1500 a year. The defendant offered in evidence an agreement between the parties limiting these commissions to five per cent. The plaintiff was permitted to prove that the *purpose* for which this agreement was executed was not to limit the amount but to induce one Woods to advance money upon the goods. The Court of Appeals of New York said:

> "Such evidence does not come within the ordinary rule of introducing parol evidence to contradict written testimony but tends to explain the circumstances under which such an instrument was executed and delivered or to show that it was cancelled or surrendered."

Such a rule obviously is necessary to prevent fraud.

The majority opinion in the court below, it is submitted, is in direct conflict with the salutary rule laid down in the cases referred to and the true rule is stated in the minority opinion to the

effect that the petitioner and his son "could have agreed that the release though general was made for the benefit of the Stock Exchange creditors only and that the transaction was as between themselves a loan by the father of the price of the seat to the son" and that in the absence of evidence showing "that any creditor of the bankrupt firm or of Eliot Atwater individually did so rely or even know of the existence of the release * * * there can be no estoppel in favor of the trustee in bankruptcy representing the creditors in general." (Opinion, WARD, CIRCUIT JUDGE, Record, p. 62).

POINT II.

The majority opinion also is in direct conflict with the decision by the highest court of the State of New York in *Sterling v. Chapin*, 185 N. Y. 395.

In *Sterling* v. *Chapin*, the testator advanced money to his brother, the defendant (they being partners in a stock brokerage business) for the purchase of a seat in the New York Stock Exchange. Testator executed a release in which he released his brother, the defendant, from all claims and demands which he had by reason of the advance, which release was delivered to the authorities of the Stock Exchange at the time of

the purchase of the seat by the defendant. The evidence showed that notwithstanding the giving of the release the parties always considered as between themselves that the indebtedness existed.

Holding that the release was not a bar to a recovery by the executor of the testator of the monies advanced, it was said by the learned Judge writing for the NEW YORK COURT OF APPEALS:

> "A rule or custom of the New York Stock Exchange required that before a person could be elected to membership, he must show that there were no outstanding claims against him, and if he had borrowed money with which to purchase his seat, it was necessary to file with the Exchange a release of this claim *for the benefit of the other members of the Exchange.*"
>
> "I have already referred to the rule of the Stock Exchange which required an assurance that a proposed member was free from indebtedness *as a protection to the members* against an claim which any person might have for moneys advanced for the purchase of the seat. The defendant was about to become such member. *** He executed the instrument which as between him and the Stock Exchange would have operated to prevent any claim for this advance in whichever form made.
>
> "So far as appears the defendant never saw or heard of it, and it seems to me that

upon this evidence alone the fair presumption would be that the testator executed the instrument simply for the limited purpose of complying with the rules of the Stock Exchange, and that otherwise said release was not intended to cancel any indebtedness."

In the present case, the purpose of the petitioner in executing the release in question is not left to implication as in the case above cited, but the purpose and intent of the petition is expressly proven by the conversations between him and his son, Eliot Atwater hereinbefore set forth.

The Court in the case cited further lays stress upon the fact that interest was charged against the defendant upon the books of the firm upon the amount advanced. Speaking of these charges of interest, the Judge writing, says:

"It seems to me that these acts are so deliberate and long continued and are so entirely inconsistent with and opposed to the idea that this indebtedness has been cancelled that we ought not to permit such effect against an estate from a purported release, executed for a mere normal consideration, unless we are compelled to. I do not think we are thus compelled to, but that in the manner indicated such effect may be given to both the release and entries on the books as will accomplish the true intent and understanding of the parties."

If the mere act of "charging interest" upon the books carries the weight of inference above set forth, how much weightier must be the conceded fact that in the case at bar each six months down to the time of the failure interest was in fact paid.

> NOTE: There is a dissenting opinion, *Sterling* vs. *Chapin*, but it does not touch the principles above involved. The dissenting Judge only claimed that under the evidence the action should have been brought, not for a co-partnership accounting, but to recover of the defendant as a claim owing to the defendant individually.

The majority opinion sought to distinguish the case cited on the ground that in that case no rights of creditors arose and that the release was delivered to the Stock Exchange and not to the borrower of the money. It is submitted the decision cited is not distinguished on these grounds. In the present case it was not shown, and this fact is expressly stated in the minority opinion of the CIRCUIT JUDGE WARD, that any creditor of the firm or of Eliot Atwater individually relied on the release or even knew of its existence and for that reason there could be no estoppel in favor of the trustees in bankruptcy representing the creditors in general. (Opinion, WARD, CIRCUIT JUDGE, Record, p. 62). The creditors therefore could have no greater rights than the debtor himself, and if as to him the release

was not effective (except as to creditors members of the Exchange) to discharge his indebtedness to his father, it could not be availed of by the general creditors. Nor, it is submitted, does it make any difference whatsoever that the release was delivered to Eliot Atwater and by him delivered to the Stock Exchange instead of a direct delivery to the Exchange as was made in the case cited. The *purpose* for and the condition on which the releases were given determine their effect and not the mere manual agency through which the delivery was made.

POINT III.

The effect of the majority decision is to create great confusion and inequality in the State of New York among creditors of insolvent Stock Exchange Members.

The membership of the Exchange is 1100 members, four-fifths of whom have executed releases of similar import to the one in suit.

In proceedings brought in the State courts of New York against an insolvent member, under the decision by the Court of Appeals in *Sterling* v. *Chapin* (*supra*) the effect of these releases though general in form may be limited to and

availed of only by creditors, members of the Exchange, while in a proceeding in the Federal courts sitting in that State, under the decision by the Court below they may be availed of by general creditors not members of the Exchange to bar the proof of a debt never intended by the parties to the releases to have been included in it.

Moreover, while under the State court decision an individual creditor, in accordance with the provisions of the Bankruptcy Act, Section 5, Clause F, may prove his debt and secure priority in payment thereof out of the individual assets of a member of an insolvent firm over claims of partnership creditors, under the decision by the Court below, an individual creditor will be barred from proving his debt, and thereby the provisions of the Bankruptcy Act will be defeated.

Thus, under the decision by the Court below firm creditors, non-members of the New York Stock Exchange, will have greater rights, and individual creditors will have less rights in the assets of an insolvent Stock Exchange firm and the members thereof, than non-member creditors pursuing their remedies in the State courts.

This dangerous and altogether inequitable situation, it is submitted, calls for a decision by this Court harmonizing the rule in the bankruptcy and other Federal courts with that in the State courts of New York.

POINT IV.

The judgment appealed from should be reversed and the claim of the Petitioner as an individual creditor of Eliot Atwater should be allowed.

Respectfully submitted,

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